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C O N F I D E N T I A L SECTION 01 OF 03 ALGIERS 001233

SIPDIS

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TAGS: ECON EFIN EINV AG
SUBJECT: NEW PRO-REFORM FINANCE MINISTER MOVING QUICKLY ON BANK PRIVATIZATION

REF: A. ALGIERS 883

¶B. ALGIERS 491

Classified By: Ambassador Richard W. Erdman, reason 1.4(b).

SUMMARY

¶1. Ambassador called on Finance Minister Mourad Medelci to extend congratulations and discuss the Minister's financial and economic vision for the country after his first five weeks in office. Medelci was bullish on the need for reform; announced the imminent privatization of three state-owned banks, with majority ownership to be made available to interested foreign firms; and said the bank payment system would become electronically automated by the end of 2005 and the bank market completely opened by the end of 2006. Medelci approved of the sovereign financing approach for the East-West Highway project, saying it would stimulate other transportation-related infrastructure development, including rail line extensions and electrification. Medelci eagerly sought foreign investment in the tourism sector. He expressed the need to send positive signals to foreign investors, acknowledging with a shrug of the shoulders that the September 2004 banking directive had negatively affected Algeria's image. Medelci intended to focus on three reforms: banking, budget, and land ownership. Algeria sought budget management training and was drafting land reform laws to create a national property market. (End Summary.)

MEDELCI ON EAST-WEST HIGHWAY
AND TOURISM DEVELOPMENT

¶2. (C) In a June 13 courtesy call to newly-installed Finance Minister Mourad Medelci, Ambassador discussed Algeria's approach to the East-West Highway project, highlighting some of what he had learned during the Ministry of Public Works' June 11 highway seminar. If the project was to be completed by the 2009 deadline set by President Bouteflika, Ambassador noted, Algeria could not afford to waste more time in selecting contractors for the three highway segments. The current approach could push a contracting decision into October, ensuring construction would not begin until well into 2006 and making it impossible for even a world-class firm like Becthel to meet the deadlines. Given the magnitude of this project ($6-7 billion) and the fact that detailed designs did not exist, in selecting a contractor (or contractors) the GOA should be looking for a strategic partnership in which trust and proven capacity for quality were paramount.

¶3. (C) Medelci acknowledged that Algeria had little experience in highway construction and that the project's plans were unfinished. However, Algeria was fortunate to have attracted a pool of interested candidates. The Ambassador was correct, Medelci said, in encouraging Algeria to opt for a sovereign financing approach rather than a consortium, which would have been more complex, more costly, and prone to delays. Absent that choice, the number of partners in the project would have been unmanageable. The prospect of a limited pool of candidates also appeared to captivate the imaginations of the project's directors. Other future projects of large scale were now being planned, including the extension of east-west rail links and the electrification of Algeria's rail lines. Experience on the highway project would give Algeria a point of reference for these infrastructure improvements. Medelci invited Ambassador to maintain the same close-working relationship with him that Ambassador had with Benachenhou, who also happened to be Medelci's long-time friend and high-school classmate.

SEEKING NON-HYDROCARBONS
INVESTMENT: TOURISM TARGETED

¶4. (C) Ambassador said U.S.-Algerian relations had been growing in recent years, and that mutual interests would continue to bring the countries together. Medelci replied that Algeria really wanted U.S. firms to invest in areas outside hydrocarbons. Tourism was the one sector in which Algeria expected to see significant developments, Algeria being the last unexplored tourist destination on the

Mediterranean. Tourism was an important link in greater regional integration and globalization, which, Medelci argued, prevented war between countries. Algerians needed to develop the proper mentality to promote tourism and create a positive investment climate for it. Ambassador said it would be important to aim for quality tourism more than mass tourism.

ON BANKING REFORM AND THE IMMINENT
PRIVATIZATION OF THREE BANKS

¶5. (C) Asked what he thought about the reform process, Medelci said reform was a means to attain an objective. The banking system, his priority for reform, needed to grow in transparency, efficiency, and security. The means to this end would be through better organization, not legislation. Algerian banks were not yet modernized, but Algeria sought to convert them fully to an electronic payments system by the end of 2005. By the end of 2006, the banking market would be fully open to competition. However, Medelci acknowledged it would not be the mechanical improvements that would increase Algeria's experience in banking; the analytical work, customer contact, and service promotion had greater roles to play in developing the sector. Algeria was still in the process of opening this market and would create a draft law on banking reform.

¶6. (C) Ambassador asked where opening three state banks to private capital stood. Medelci said privatization of three banks (CPA, BNA, and BDL) was imminent. The tenders for the banks would be released "within a few weeks." As a result of recent decisions, the GOA had dropped its earlier limits on private participation (first 30%, then 47%) and would now permit foreign 51-percent private majority ownership of the Algerian banks, and maybe more. Until now, Medelci said, not many U.S. banks had expressed interest in acquiring state banks. Requiring foreigners to hold minority stakes would lead to the degredation of the foreign banks, when the real goal was to bring in best-practices from abroad. (Comment: The decision to proceed with three bank privatizations at once, instead of piecemeal, is significant in that the Ministry of Finance succeeded in establishing that there would be no foreign buyers if only minority stakes were offered. End Comment.) Ambassador said this decision would enable foreign private banks to train a new generation of Algerian bankers in modern banking methods.

¶7. (C) Turning to the September 2004 banking directive requiring public companies to hold accounts in public banks (leading to a 25% loss in business at Citibank Algeria), Ambassador emphasized it was important for Algeria to send positive signals to foreign investors. The banking directive did the opposite. Medelci, noting this had been a high level decision that he had to live with for now, said he understood "very well" this outcome and that his Ministry would progressively try to send positive messages to counteract the negative effects of the directive. Ambassador also mentioned that during Temmar's late 2004 visit to the U.S., Paul Volcker had offered to review Algeria's banking reform plans. Medelci said he would talk to Temmar to see if the plan was ready for review.

MEDELCI'S TOP THREE PRIORITIES
AND VIEWS ON THE INFORMAL MARKET

¶8. (C) Algeria's top three reform priorities from Medelci's perspective were banking reform, budget reform, and land reform. With regard to budget reform, Algeria did not have good action plans to improve budget forecasting and management. The execution of financial plans needed to be more transparent; Algeria had already sought World Bank assistance in this area. On land reform, Medelci said Algeria needed to clarify land ownership, which was a source of many legal problems, and create a property market. Algeria was putting together a draft law to accelerate this transition. The government was the sole authority for approving private land purchases, a process that needed to change. Inter-ministerial talks would address this issue.

¶9. (C) The most complex economic question, Medelci admitted, was that of the informal economy, which was "nourished by bad economic policies." If the informal market was caused by people fleeing taxes, he wondered aloud, then perhaps the government needed to ask itself if the tax rates were too high. Part of the motivation for the informal economy stemmed from a desire for mobility. Algeria countered this by taking steps making it easier to apply for legitimate business licenses, reducing the number of approvals required to three. The ANSEJ (youth employment agency) loans-to-youth program was expected to encourage the development of 150,000 small businesses over three years. This could have the effect of reducing the size of the informal market -- a market that already existed 15 years ago and was now three-times larger because of terrorism's intervening effects

on the economy. Algeria needed to catch-up and better control the informal market.

¶10. (C) In closing, Ambassador suggested that the GOA and private sector needed to communicate better and see each other as strategic partners. The government provided the playing field and the private sector provided the players, but both were necessary to score goals. In this regard, he recalled a recent conversation with a leading Algerian business owner, who said the government should be making his life easier, not more difficult, because he paid over $100 million a year in taxes and the government was thus in effect his largest share-holder. GOA officials, continued Ambassador, in turn complained that the private sector still treated the government as an adversary despite the fact it has made clear its commitment to privatization and an open market system dominated by the private sector. Medelci agreed with the need for dialogue and noted that he had invited members of business-owners organizations to attend lunch at the Ministry that same day. It was the first time they had ever set foot in the Ministry! (Comment: Ambassador gave a public speech June 4 in which he urged better government-private sector communication.)

COMMENT

¶11. (C) Medelci is part of the same pro-reform class as his predecessor. With three bank privatizations to be announced during his first few months in office, he will be overseeing a critical phase of Algeria's transition to a market economy. His comments indicate he has a strong grasp of Algeria's economic weaknesses, and he has clearly prioritized his plan of action. His focus on the tourism sector seems, from our perspective, to be astray; Algeria's plans for rapid development of tourism seem overly optimistic. The country lacks the proper infrastructure, the services, and the mindset (as Medelci admitted) for tourism to flourish.

ERDMAN